



**COUNTY OF LOS ANGELES  
DEPARTMENT OF AUDITOR-CONTROLLER**

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J. TYLER McCAULEY  
AUDITOR-CONTROLLER

October 31, 2002

TO: Supervisor Zev Yaroslavsky, Chairman  
Supervisor Gloria Molina  
Supervisor Yvonne Brathwaite Burke  
Supervisor Don Knabe  
Supervisor Michael D. Antonovich

FROM: J. Tyler McCauley   
Auditor-Controller

SUBJECT: **Department of Health Services  
Community Health Plan Fiscal Year 2001-2002 Financial Audit**

Attached is a copy of the independent auditor's report and management letter for the Department of Health Services' Community Health Plan (CHP) fiscal year (FY) 2001-2002 financial audit. The audit was performed by Simpson & Simpson, Certified Public Accountants (Simpson).

California law requires CHP and other managed care plans to submit annual financial statements that have been audited by an independent certified public accountant to the State Department of Managed Health Care. The statements must be accompanied by an opinion on the fairness of the financial statement presentation. Simpson expressed an unqualified opinion on the CHP's financial statements for FY 2001-2002. CHP has submitted the report to the Department of Managed Health Care, as required.

**Internal Control Findings**

In prior years, auditors noted that CHP does not have the resources (e.g., computer system, staff, space, etc.) to process claims accurately and timely. During FYs 1999-2000 and 2000-2001, CHP implemented most of the recommended actions, but still needs to replace its current computer system or outsource some of their administrative functions to fully implement the recommendations. Simpson continues to note this as a reportable condition in their current year Report on Compliance and Internal Control over Financial Reporting.

Simpson also continues to report previously identified weaknesses in the CHP's internal control structure such as, deficiencies in the patient management system, reconciliation of revenues with enrollment, methods of accounting for cost of health care and inability to handle increased growth. Some of these weaknesses continue to be reported because they relate to the purchase of a new computer system or the outsourcing of some of CHP's administrative functions discussed earlier.

Simpson also noted an additional reportable condition related to CHP's method of estimating reserves for future health care expenses. Simpson indicated that CHP's methodology could result in CHP over-accumulating reserves.

These weaknesses, along with CHP management's responses, are discussed in Simpson's Report on Compliance and Internal Control over Financial Reporting.

If you have any questions, please call me or your staff can contact DeWitt Roberts at (213) 974-0301.

JTM:DR:js

Attachments

C: David E. Janssen, CAO  
Department of Health Services  
Thomas L. Garthwaite, M.D., Director and Chief Medical Officer  
Gary Wells, Director of Finance  
Dave Beck, Office of Managed Care  
Sachai Hamai, Inspection & Audit  
Lloyd W. Pellman, County Counsel  
Violet Varona-Lukens, Executive Office  
Public Information Officer  
Audit Committee

October 10, 2002

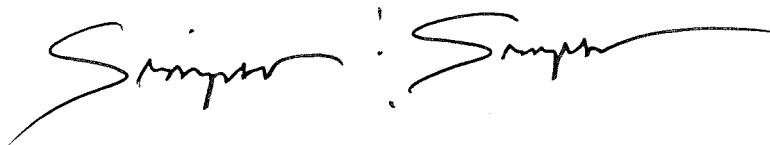
To the Board of Supervisors of  
the County of Los Angeles

Dear Board Members:

In planning and performing our audit of the financial statements of the Community Health Plan (CHP) for the year ended June 30, 2002 (on which we have issued our report dated October 10, 2002), we considered the internal control structure in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements of CHP and not to provide assurance on the internal control structure. Such consideration would not disclose all matters in the internal control structure that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities, in amounts that would be material in relation to the financial statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. However, we noted no matters involving the internal control structure and its operations that we consider to be a material weakness as defined above.

We have noted other matters relating to the internal control structure and certain other accounting, administrative, or operating matters. Our observations and recommendations are presented in Exhibit I. We have not performed any substantive auditing procedures subsequent to October 10, 2002, accordingly, this report is based on our knowledge as of such date and should be read with that understanding.

Sincerely,



**Observation # 1 – Deficiencies in the MS Money/Patient Management System****Condition**

CHP records its transactions with using MS Money, a personal financial management software, as opposed to an accounting package complete with a general ledger, accounts receivable and accounts payable ledgers. MS Money allows deletion of transactions without leaving any audit trail. It also cannot general reports such as detail receivable and payable schedules.

CHP's Patient Management System (PMS), the system for tracking claims, does not integrate with MS Money. Accounting staff generates various claims status reports from PMS and makes monthly accounting journal entries in MS Money based on the amounts from the reports. However, the PMS system is antiquated and extracting information from the system requires much programming effort. Errors made in the programming of the reports may lead to the recording of inaccurate information into MS Money.

**Recommendation**

CHP should use a fully integrated software program that meets its needs. Such a system will reduce the risk of human data entry errors, provide a better audit trail for transactions, and allow for better analysis of accounts.

**Response**

CHP agrees with the recommendation and is currently in negotiations to outsource a variety of administrative functions, including the managed care information systems with a fully integrated general ledger to automate the above functions.

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**Observation #2 – Retroactive Adjustments Not Made to Contracted Providers****Condition**

CHP receives retroactive adjustments in capitation for supplemental enrollments and disenrollments of members for the previous month. However, CHP has not passed on the retroactive adjustments to the CHP network providers due to inherent limitations in its existing information system. Total liability to the contract providers related to retroactive adjustments amounted to approximately \$1.5 million as of June 30, 2002.

**Recommendation**

We recommend that CHP develop and implement changes to its existing information system to enable it to pass on the retroactive adjustments to the appropriate network providers.

**Response**

CHP agrees and will develop and implement a system to distribute retroactive adjustments to network providers.

**Observation # 3 – Method of Accounting for Cost of Health Care****Condition**

CHP makes monthly provisions for reserves for claims and charges the cost of health care services expense accounts based on a percentage of the capitation revenue. When CHP receives claims from service providers, the total amount of claims received are transferred from the reserve account to the claims pending account.

CHP began this practice since it began operations, and it was more appropriate during the early days with lower enrollments since it did not result in a significant reserves balance at the end of the fiscal year, and it assisted management to closely match the monthly revenues and expenses during the early growth periods. Now that CHP's capitation revenues have increased significantly from the early days due to increased enrollment, continuing such practice may result in a significant accumulation in the reserves balance and over-charging the cost of health care service expense accounts by the amount of the reserves balance.

**Recommendation**

We recommend that CHP record the monthly cost of health care services based on actual claims received and an estimate of claims incurred by not received.

**Response**

CHP agrees with the recommendation in concept. However CHP intends to continue its current practice but will perform quarterly reviews of the reserves balance and make adjustments if needed to ascertain that interim financial statements are fairly stated.

**Observation #4 – Interest Included in Claims Payments****Condition**

CHP pays interest on those claims which are paid after 45 business days from the date of receipt of the claim. The total payment, including the interest portion, is debited from the claims payable account when the claims are paid. Accordingly, interest expense and claims payable balance is understated. Currently, management estimates that such understatement is not material to the financial statements. However, the condition if ignored, could lead to larger inaccuracies of the account balances over time.

**Recommendation**

We recommend that CHP determine the interest portion of the claim payments and record it accordingly in the accounting system.

**Response**

CHP agrees in concept. However, due to the pending outsourcing of the information systems and general ledger functions as well as the relative immateriality of the amount of interests incurred, it is not cost-effective to implement such a change at this time.

**Observation #5 – Ability to Handle Increased Growth**

**Condition**

The infrastructure, personnel, internal controls and current computer systems (administrative capacity) in place at the CHP may not be able to keep up with the projected growth of CHP. Many of the processes of CHP are manually intensive, e.g. calculation of capitation and IBNR. The internal checks and balances necessary for a strong internal control environment are inadequate due to limited staffing arrangements.

**Recommendation**

CHP needs to automate its manual intensive processes as quickly as possible in order to remain competitive in the managed care market and handle the projected growth of the plan.

**Response**

CHP agrees with the recommendation. As stated above, the Office of Managed Care is in negotiations to outsource the managed care information system. The new system should eliminate the manual processes identified in this recommendation.

**LOS ANGELES COUNTY  
DEPARTMENT OF HEALTH SERVICES  
COMMUNITY HEALTH PLAN**

**Financial Statements for the  
Year Ended June 30, 2002  
with Independent Auditor's Report**

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*Simpson & Simpson*

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**LOS ANGELES COUNTY  
DEPARTMENT OF HEALTH SERVICES  
COMMUNITY HEALTH PLAN  
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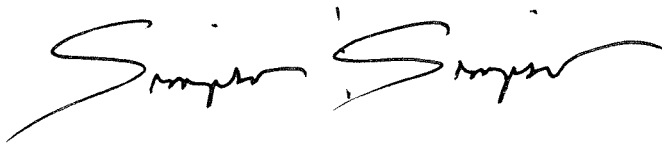
## INDEPENDENT AUDITOR'S REPORT

To the Board of Supervisors of  
the County of Los Angeles

We have audited the accompanying balance sheet of the Los Angeles County Department of Health Services Community Health Plan (CHP) as of June 30, 2002 and the related statement of income and changes in fund balance, and cash flows for the year then ended. These financial statements are the responsibility of CHP's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of CHP as of June 30, 2002 and the results of its operations, changes in its net assets and its cash flows for the year then ended in conformity with generally accepted accounting principles in the United States of America.



Los Angeles, California  
October 10, 2002

**LOS ANGELES COUNTY  
DEPARTMENT OF HEALTH SERVICES  
COMMUNITY HEALTH PLAN  
Balance Sheet  
June 30, 2002**

**ASSETS**

Current assets:

Cash equivalents	\$ 40,162,925
Receivables (Note 3)	15,962,506
Amount due from Los Angeles County, net (Note 4)	<u>4,908,838</u>
Total current assets	<u>61,034,269</u>

Noncurrent assets:

Long-term investments	<u>302,394</u>
Total noncurrent assets	<u>302,394</u>

<b>TOTAL ASSETS</b>	<b>\$ <u>61,336,663</u></b>
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**LIABILITIES AND FUND BALANCES**

Current liabilities:

Accrued capitation	\$ 18,129,826
Claims payable (Note 5)	1,692,391
Accounts payable	2,029,232
Accrued salaries and related benefits	<u>1,549,648</u>
Total current liabilities	<u>23,401,097</u>

Fund balances:

Restricted	3,362,368
Unrestricted	<u>34,573,198</u>
Total fund balance	<u>37,935,566</u>

<b>TOTAL LIABILITIES AND FUND BALANCE</b>	<b>\$ <u>61,336,663</u></b>
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*The accompanying notes are an integral part of these financial statements.*

**LOS ANGELES COUNTY**  
**DEPARTMENT OF HEALTH SERVICES**  
**COMMUNITY HEALTH PLAN**  
**Statement of Income and Changes in Fund Balance**  
**Year Ended June 30, 2002**

<b>REVENUES</b>	
Capitation premiums	\$ 155,997,422
<b>OPERATING EXPENSES</b>	
Cost of health care services:	
Capitation premiums	108,773,106
Medical services	2,685,064
Pharmacy	14,212,504
Medical supplies	643,285
Total cost of health care services	<u>126,313,959</u>
General and administrative:	
Salaries and employee benefits	7,675,075
Professional and consulting services	5,112,664
Rent	999,609
Office expense	333,726
Communications	219,042
Miscellaneous	99,969
Total general and administrative expenditures	<u>14,440,085</u>
Total operating expenses	<u>140,754,044</u>
<b>OPERATING INCOME</b>	<b>15,243,378</b>
<b>OTHER REVENUES (EXPENSES)</b>	
Interest income	1,928,924
Interest expense	<u>(88,281)</u>
Total other revenues (expenses)	<u>1,840,643</u>
Income before unusual or infrequent items	17,084,021
<b>UNUSUAL OR INFREQUENT ITEMS</b>	
Write-down of accrued capitation (Note 6)	<u>10,440,654</u>
Net income	27,524,675
Restated fund balance, beginning of year (Note 7)	<u>10,410,891</u>
Fund balance, end of year	<u><u>\$ 37,935,566</u></u>

*The accompanying notes are an integral part of these financial statements.*

**LOS ANGELES COUNTY  
DEPARTMENT OF HEALTH SERVICES  
COMMUNITY HEALTH PLAN  
Statement of Cash Flows  
Year Ended June 30, 2002**

**CASH FLOWS FROM OPERATING ACTIVITIES**

Net income	\$ 27,524,675
Adjustments to reconcile change in net assets to net cash Used by operating activities	
Changes in operating assets and liabilities:	
Increase in receivables	(4,695,548)
Increase in amount due from Los Angeles County, net	(21,779,869)
Increase in accrued capitation	253,051
Decrease in claims payable	(4,042,755)
Increase in accounts payable	931,858
Increase accrued salaries and related benefits	319,635
Net cash used by operating activities	<u>(1,488,953)</u>
Net decrease in cash equivalents	(1,488,953)
Balance, beginning of the year	<u>41,651,878</u>
Balance, end of the year	<u><u>\$ 40,162,925</u></u>

*The accompanying notes are an integral part of these financial statements.*

**LOS ANGELES COUNTY  
DEPARTMENT OF HEALTH SERVICES  
COMMUNITY HEALTH PLAN  
Notes to Financial Statements  
June 30, 2002**

**NOTE 1 – ORGANIZATION AND NATURE OF BUSINESS**

The Community Health Plan (CHP) is the Medi-Cal health maintenance organization (HMO) owned and operated by the Los Angeles County Department of Health Services (DHS). It is a federally qualified HMO and is licensed as a prepaid full service health care service plan by the State of California Department of Managed Health Care under the Knox-Keene Health Care Service Plan Act of 1975. CHP provides health care services at low or no cost through the State's Medi-Cal Managed Care and Healthy Families Program, the Los Angeles County's Temporary Employees Program and the Personal Assistance Services Council - Service Employees International Union (PASC-SEIU) Homecare Worker Health Care Plan.

Medi-Cal Managed Care

CHP is one of five Plan Partners contracting with L.A. Care Health Plan, the Local Health Initiative for Medi-Cal Managed Care in Los Angeles County. CHP has over 800 primary care physicians, over 600 pharmacies, including the chain of Rite-Aid stores, and more than a thousand specialists in the Medi-Cal provider network. Under the Medi-Cal program there is no cost to the member for covered services and no co-payments.

Healthy Families Program

CHP contracts with the State Managed Risk Medical Insurance Board (MRMIB) to participate as a Healthy Families Program provider. The Healthy Families Program provides comprehensive health, dental and vision coverage to children in families with incomes at or below 250% of the Federal Income Guidelines. Since the program began in 1998, Community Health Plan has been designated the Community Provider Plan for Los Angeles County for the provision of health coverage.

County's Temporary Employees Program

CHP provides managed health care services to certain long-term (continuously employed for one year or more), full-time, temporary employees of the County of Los Angeles. This coverage excludes physicians, relief nurses receiving special cash compensation in lieu of employee benefits, and all student positions receive this coverage. Qualified Temporary County Employees have access to the same provider network as do the members enrolled under the Medi-Cal Managed Care Program.

PASC-SEIU Homecare Worker Health Care Plan

Effective April 1, 2002, the PASC-SEIU Homecare Worker Health Care Plan was implemented to provide health services to eligible In-Home Supportive Services (IHSS) Workers. The plan provides IHSS Workers access to a provider network comprised of Los Angeles County Department of Health Services facilities and contract providers.

**LOS ANGELES COUNTY  
DEPARTMENT OF HEALTH SERVICES  
COMMUNITY HEALTH PLAN  
Notes to Financial Statements  
June 30, 2002**

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

As a managed health care organization, CHP derives the majority of its revenues from capitation premiums received for providing prepaid health services and prepares its financial statements in accordance with the AICPA Audit and Accounting Guide for "Health Care Organizations." The following is a summary of significant accounting policies used in the preparation of the accompanying consolidated financial statements. Such policies are in accordance with accounting principles generally accepted in the United States of America and have been consistently applied. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses for each reporting period. The significant estimates made in the preparation of CHP's financial statements relate to the assessment of the carrying value of claims payable and contingent liabilities. While management believes that the carrying value of such assets and liabilities is adequate as of June 30, 2002, actual results could differ from the estimates upon which the carrying values were based.

**Basis of Presentation - Fund Accounting**

The accounts of the County are organized on the basis of funds and account groups, each of which is a separate accounting entity. Each fund is accounted for through a separate set of accounts that comprise its assets, liabilities, fund equity, revenues and expenditures or expenses, as appropriate. CHP is reported under an enterprise fund of the proprietary fund type of the County of Los Angeles. Enterprise funds are used to account for operations that are financed and operated in a manner similar to private business enterprises, where the intent of the governing body is that the cost or expenses of providing goods and services to the public on a continuing basis be financed or recovered through user charges. All proprietary funds are accounted for using the accrual basis of accounting. Revenues are recognized when they are earned, and expenses are recognized when they are incurred.

**Accounting Standards**

Pursuant to Governmental Accounting Standards Board (GASB) Statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting, CHP has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989.

**Concentration of Source of Revenues**

CHP received approximately 86% of its premium revenues under service agreements with L.A. Care Health Plan for the fiscal year ended June 30, 2002.

**LOS ANGELES COUNTY  
DEPARTMENT OF HEALTH SERVICES  
COMMUNITY HEALTH PLAN  
Notes to Financial Statements  
June 30, 2002**

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Cash Equivalents

Cash equivalents consist of CHP's equity portion of the Los Angeles County cash and investment pool. Funds received by CHP are deposited into the cash and investment pool for which the County Treasury is the depository. Funds deposited in the pool are similar in nature to demand deposits, (i.e., funds may be deposited and withdrawn at any time without prior notice or penalty). Interest earned on the pooled funds is accrued in a pooled interest apportionment fund and is allocated based on the average daily cash balances of the fund. The average annual interest rate earned on CHP's deposits during fiscal year ended June 30, 2002 was approximately 3.48%. As of June 30, 2002, substantially all investments in the County investment pool were U.S. government securities, bankers' acceptances and negotiable certificates of deposit.

Long-Term Investments

Long-term investments consist of restricted investments on deposit with the California Department of Managed Health Care (DMHC). These investments consist of U.S. Treasury securities, and due to their restricted nature, are classified as long-term without regard to contractual maturity. Market values approximate carrying values as of June 30, 2002.

Claims Reimbursement Receivable

Claims reimbursement receivable are claims for capitated services paid by CHP that are reimbursable from the contracted medical groups and hospitals. Management believes that uncollectible amounts, if any, will not be material to the financial statements.

Accrued Capitation

CHP pays capitation premiums to the contracted medical groups and hospitals in arrears on a per member per month basis. Accrued capitation consists of capitation payments due the contracted medical groups and hospitals.

Claims Payable

The liability for claims payable includes adjudicated claims, claims pending adjudication and a provision for incurred but not reported claims. The amount payable for the claims pending adjudication is reduced by an allowance for denied claims estimated based on paid/denied ratio of claims closed during the year. The provision for incurred but not reported claims is estimated using a lag study based upon historical data including the period between the date services are rendered and the date claims are received and paid and denied claim activity. The estimate for incurred but not reported claims is made on an accrual basis and adjusted in future periods as required.

**LOS ANGELES COUNTY  
DEPARTMENT OF HEALTH SERVICES  
COMMUNITY HEALTH PLAN  
Notes to Financial Statements  
June 30, 2002**

**NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Any adjustments to the prior period estimates are included in the current period. Such estimates are subject to the impact of changes in the regulatory environment and economic conditions. Given the inherent variability of such estimates, the actual liability could differ significantly from the amounts provided. While the ultimate amount of claims and losses paid are dependent on future developments, management is of the opinion that the recorded reserves are adequate to cover such costs. These liabilities are reduced by estimated amounts recoverable from contracted health care providers.

**Fund Balance**

Fund balances are reported as restricted when constraints placed on its use are either: (1) externally imposed by creditors, grantors, contributors or laws or regulations of other governments, or (2) imposed by law through constitutional provisions or enabling legislation. CHP's restricted fund balance consists of the amounts required to satisfy the deposit and tangible net equity requirements of the Department of Managed Health Care as of June 30, 2002 (see Note 10).

**Premium Revenues**

CHP's premium revenues are capitation payments received for plan enrollees on a per member per month basis. Premiums are recognized as revenue in the month in which the members are entitled to service.

**Cost of Health Care Services**

CHP contracts with various medical groups to provide professional care to its members on a capitated, or fixed per member per month fee basis. Capitation contracts generally include a provision for stop-loss and non-capitated services for which CHP is liable. Additionally, the Company contracts with certain hospitals to provide hospital care to enrolled members on a capitation basis.

The cost of health care services is recognized in the period in which services are provided and includes an estimate of the cost of services which have been incurred but not yet reported. Such costs include capitation payments to contracted medical groups and hospitals for primary care, specialty and hospital services and the cost of non-capitated medical services, pharmacy and medical supplies.

**Fair Value of Financial Instruments**

The estimated fair value amounts of cash equivalents and long-term investments approximate their carrying amounts in the financial statements and have been determined by the Company using available market information and appropriate valuation methodologies. The carrying amounts of cash equivalents approximate fair value due to the similar in its nature to demand deposits. The fair values of long-term



**LOS ANGELES COUNTY  
DEPARTMENT OF HEALTH SERVICES  
COMMUNITY HEALTH PLAN  
Notes to Financial Statements  
June 30, 2002**

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

investments are estimated based on quoted market prices and dealer quotes for similar investments.

Income Tax

As an operating division of the County, CHP is exempt from State and Federal income taxes.

NOTE 3 – RECEIVABLES

Receivables are comprised of capitation premiums receivable and claims reimbursement receivable from non-County service providers. As of June 30, 2002, receivables consisted of the following:

Capitation premiums receivable	\$ 15,322,617
Claims reimbursement receivable	639,889
	<u>\$ 15,962,506</u>

NOTE 4 - AMOUNT DUE FROM LOS ANGELES COUNTY, NET

Cash disbursements for CHP are made from the general fund of Los Angeles County Department of Health Services (DHS). CHP transfers funds periodically to the general fund from its County cash and investment pool to reimburse the general fund or to fund its projected cash disbursements. The net amount due from Los Angeles County is comprised of the amount owed to or from the DHS general fund, claims reimbursement receivable for out-of-plan claims paid by CHP on behalf of County medical facilities, interest receivable from the County Treasury for interest accrued on its portion of the County cash and investment pool, and the amount due other County funds for services such as telephone, rent and information system support. As of June 30, 2002, the net amount due from Los Angeles County consisted of the following:

Amount due from DHS general fund	\$ 2,870,211
Claims reimbursement receivable	3,734,768
Interest receivable	415,174
Amount due other County funds	(2,111,315)
	<u>\$ 4,908,838</u>

*These notes are an integral part of the preceding financial statements.*

**LOS ANGELES COUNTY  
DEPARTMENT OF HEALTH SERVICES  
COMMUNITY HEALTH PLAN  
Notes to Financial Statements  
June 30, 2002**

**NOTE 5 - CLAIMS PAYABLE**

Claims payable are comprised of claims payable or pending adjudication and a liability for claims incurred but not yet received, reduced by management's estimate of the amount that will be denied and the amount that will be recoverable from contracted providers. As of June 30, 2002, claims payable consisted of the following:

Claims payable/pending adjudication	\$ 10,955,355
Claims incurred but not received	<u>15,474,983</u>
	26,430,338
Less: Allowance for denied claims	(20,345,230)
Less: Estimated recoverable amounts	<u>(4,392,717)</u>
	<u>\$ 1,692,391</u>

**NOTE 6 – WRITE-DOWN OF ACCRUED CAPITATION**

CHP periodically receives capitation rate increases or decreases from L.A. Care., and under CHP's contracts with the capitated providers, CHP may elect to adjust the capitation rates paid to its providers by a proportionate amount. For the fiscal years prior to June 30, 2001, management recorded adjustments to capitation premium expense and accrued capitation liability for the proportionate amount of the adjustments that may be passed on to the capitated providers. However, CHP has not made any corresponding changes to the capitation rates paid to the providers since October 2000. As of June 30, 2001, the net effect of such adjustments amounted to a liability in the amount of \$10,440,654. Management made the decision in June 2002 not to pass on the rate adjustments to the providers and wrote-down the corresponding liability.

**NOTE 7 – RESTATED BEGINNING FUND BALANCE**

The fund balance at June 30, 2001 has been restated from the balance previously reported to reflect adjustments of \$5,364,600 for overstatements of cost of health services of \$526,558, \$805,803, \$2,628,624, \$991,951 and \$411,664 in the fiscal years ended June 30, 2001, 2000, 1999, 1998 and 1997 respectively.

**NOTE 8 - RETIREMENT PLAN**

The County's retirement plan covers CHP employees and provides for monthly pension payments to eligible employees upon retirement. Salaries and employee benefits expense includes a provision for the retirement plan cost, as well as vacation and sick pay, which is estimated based on a percentage of salaries expense. The actual cost of the retirement plan, actuarial present value of accumulated retirement plan benefits, and net assets available for retirement plan benefits are not separately identifiable for CHP.

**LOS ANGELES COUNTY  
DEPARTMENT OF HEALTH SERVICES  
COMMUNITY HEALTH PLAN  
Notes to Financial Statements  
June 30, 2002**

**NOTE 9 - CONTINGENCIES**

Universal Care Inc., a health maintenance organization which contracts with CHP for the provision of services to Healthy Family Program subscribers, disputes the amount of capitation that it has received under its contract with the CHP, as well as several aspects of subscriber enrollment and assignment. Universal Care Inc. filed a Demand for Arbitration in September 2001 against CHP. The parties are in the process of discovery and no hearing date has been set. Management estimates the amount owed to be approximately \$538,222 as of June 30, 2002, and includes the liability as accrued capitation as of June 30, 2002.

The County has agreed to fund CHP losses, if any, and to cover CHP under its self-insured medical malpractice program when medical services are provided at a County facility. In addition, the County has agreed to cover CHP under its self-insured workers' compensation program. These coverages are provided to CHP at no cost.

**NOTE 10 - REGULATORY REQUIREMENTS**

CHP, as a California licensed health service plan, is regulated by the State of California Department of Managed Health Care (DMHC). Title 28 of the Code of California Regulations requires that CHP maintain certain deposits assigned to the Director of the DMHC and comply with certain minimal capital or tangible net equity requirements. Management believes that as of June 30, 2002, CHP met its regulatory requirements.